

STAKING INDICES' UNTAPPED POTENTIAL

INTRODUCTION

The exceptional performance of Bitcoin ETFs last year has set a high bar for all future digital asset structured products. Any future offering in the space, such as the ETH ETFs launched last summer, are inevitably judged against these BTC funds. While many crypto-native investors have viewed ETH ETFs as disappointing in comparison, it is without knowing that BlackRock's ETHA fund was among the top six ETF launches of 2024, attracting over \$3.5bn in inflows.

A key factor behind the lukewarm reception from the crypto community stems from the limited functionality of these Ether ETFs, which launched without staking rewards. This could change in 2025, potentially catalyzing renewed interest in ETH and other proof-of-stake assets. In this report, we examine the role of staking indices in financial products, explore their mechanics, and assess the potential size of the global market.

KEY POINTS

- Cash-flow benefits of staking
- Staking in financial products
- Existing Precedent

DEFINITIONS

Staking refers to the process by which validators secure a proof-of-stake (PoS) blockchain. It involves users committing collateral, in the form of the network's token, to validate blocks and contribute to the security of the network. Ethereum, Solana, and Cardano are among the most well-known PoS blockchains. Proof-of-work (PoW) is the most prominent alternative consensus mechanism; unlike PoS, PoW relies on computational power to confirm new blocks. Bitcoin operates using PoW.

Ethereum transitioned to PoS after The Merge in 2022 and is now the most widely recognized and utilized PoS blockchain. Users who stake on the Ethereum network currently receive a yield (known as staking rewards) of 3.1% annually for committing their ETH to confirm new blocks. These staking rewards make ETH a cash-flow-generating asset and set it apart from BTC. Ethereum is not alone: Solana, Cardano, and Avalanche are other examples of PoS tokens vying for spot ETF products in the United States.

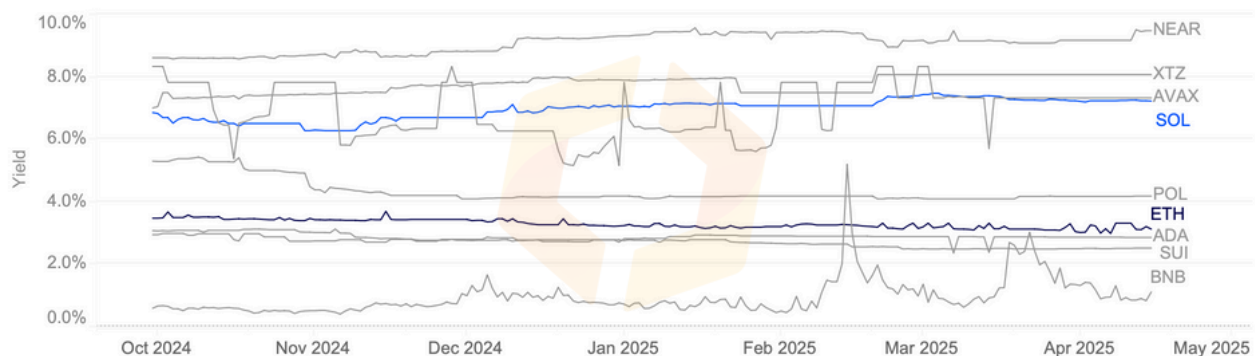
STAKING YIELDS: BARRIERS & OUTLOOK

Investors of U.S. ETH ETFs in 2024 were excluded from any potential staking profits because the SEC explicitly required that spot ETH ETFs do not stake or otherwise use the underlying ETH to earn yield, due to regulatory concerns around the operational, legal, and custodial risks associated with staking activities.

However, this will likely change before the end of 2025 or at least by early 2026, as regulatory discussions are ongoing, several asset managers have submitted proposals for staking-enabled ETFs, and there is increasing industry focus on providing access to staking yields within regulated investment products.

ETH isn't the only concerned asset that is able to produce cash-flows for investors. These alternative networks can also offer much higher rewards than ETH. For instance, SOL rewards are consistently above 7%, more than double ETH.

Staking Yields by Asset



Source: Public data, calculations by Kaiko Indices.

FINDING A ROUTE TO STAKING REWARDS

Key considerations when incorporating staking rewards into financial products include regulatory compliance and index methodology.

Regulatory constraints may limit the ability to offer staking yields to investors. For example, previous leadership at the U.S. Securities and Exchange Commission expressed opposition to staking—whether as a service provided by exchanges or as a component of ETH indices—viewing it as a potential violation of securities laws. Additional regulatory concerns include determining what proportion of a fund can be allocated to staking and whether this might affect the fund’s ability to meet redemption requests. For instance, if 100% of the fund is staked and subject to a staking queue, redemptions could become impossible—an issue that raises significant concerns for regulators worldwide.

Once regulatory factors have been addressed, index methodology becomes the next critical consideration. A common approach is to use a total return index, which measures the performance of the asset or basket of assets while also accounting for all cash distributions, such as staking rewards. For example, a hypothetical ETH total return index could track daily performance while staking a portion of the fund. The staking utilization rate would fluctuate, and rewards would be compounded daily.

STAKE: THE CRYPTO STAKING INDEX

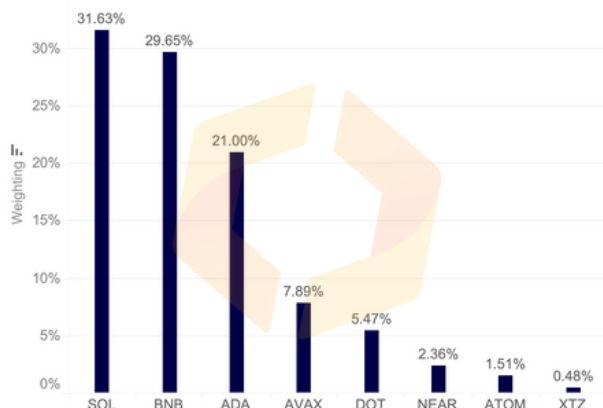
Staking has already been included in live ETPs in Europe for several years. One example is the 21Shares STAKE ETP, powered by Kaiko Indices’ custom crypto staking index, which saw its returns soar following the U.S. election in November.

STAKE is a basket ETP that invests in major Proof-of-Stake (PoS) tokens. All constituent assets are staked, and the yield generated is incorporated into the index’s returns. SOL, BNB, and ADA are the largest assets by weight in STAKE. It currently has a 30-day trailing yield of 1.95% from its staking activities.

The percentage of each asset staked, or its utilization rate, depends on factors such as lock-up periods and liquidity. The utilization rate ranges from 0 to 100%. All assets are unstaked in the lead-up to rebalancing; as a result, the index is only rebalanced once every six months to minimize the time assets are unstaked.

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STAKE Index Constituent Assets



Source: STAKE, Kaiko Custom Indices.

STAKE Index Performance



Source: STAKE, Kaiko Custom Indices.

THE NEED FOR FAST REDEMPTIONS

The index only includes assets with institutional-grade staking support. At the time of its inception, the Shanghai upgrade had not yet taken place, so ETH was not eligible for inclusion. Even now, potential risks remain due to possible delays in staking and unstaking ETH. Fast and easy redemptions are essential because ETPs rely on the ability to create and redeem shares efficiently to maintain liquidity and accurately track the underlying assets. If assets cannot be quickly unstaked and redeemed, it could disrupt the product's functioning and investor access. As a result, ETH remains ineligible for inclusion in STAKE, though this is reassessed semi-annually when the index is rebalanced.

PRECEDENT IN FINANCIAL MARKETS

While staking is rather unique to digital assets, the practice of generating yield from idle assets isn't. In traditional markets there is somewhat comparable offering known as securities lending.

This is a long established practise in traditional markets and offers increased returns for investors by lending out assets in the fund. This works by allowing a fund to temporarily lend assets to an approved borrower in return for a fee and once there is sufficient collateral. Investors in that fund benefit from improved returns based on the fees generated from this lending practise.

While ETH and other PoS tokens are not securities, the process of staking through a third party does have some similarities with this practice—albeit staking offers higher returns.

| | Securities Lending | Staking |
|---------------------------|------------------------------------|--|
| Purpose | Generate income from idle assets. | Contribute to the security of the network and generate income from idle assets |
| Asset | Traditional assets such as stocks. | Digital assets with PoS consensus mechanisms |
| Source of Yield | Fees and interest | Staking yield |
| Lock-up Period | Flexible | Varies by asset, typically up to 27 hours for ETH |
| Counterparty risks | Borrowers default | Validator misconduct (slashing) |

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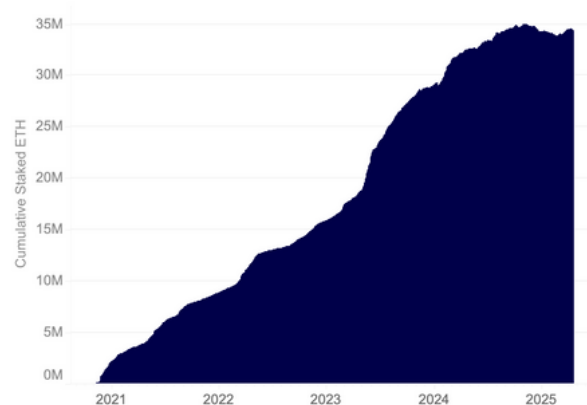
This comparison serves to illustrate the existing precedent for deploying idle funds within financial products to generate additional income for investors. If staking receives approval from the new SEC leadership, it is unlikely that funds will be lent out to staking providers in the traditional sense. For example, Coinbase offers a staking solution and already acts as custodian for most ETH ETFs, enabling seamless integration of staking activities. In this scenario, fund performance could be benchmarked against a total return index that incorporates the yield generated from staking.

MARKET FOR STAKING

How significant is the staking opportunity for financial products? Currently, over 34 million ETH are staked on the Beacon Chain. At today's prices, the Ethereum staking market alone is valued at more than \$50 billion—twice the market capitalization of DOGE, for context.

However, it's not just the size of the market that makes staking compelling. For most investors, staking involves considerable friction and complexity. For example, Ethereum requires solo stakers to hold a minimum of 32 ETH—an investment of around \$50,000, which is out of reach for many. By incorporating staking into indices and financial products, these benefits can be extended to a broader range of investors, making network participation and security more accessible.

Total ETH Staked



Source: Kaiko Blockchain Monitoring Tool.

CONCLUSION

The exclusion of staking from U.S. ETH ETFs in 2024 likely dampened the appeal of these products among crypto-native investors, despite their strong inflows. A potential regulatory shift in the U.S. could change this dynamic, as staking introduces a new dimension to ETH and other Proof-of-Stake assets. The addition of staking could significantly boost inflows into existing and upcoming products, given the ease with which investors could access enhanced returns. Moreover, there is precedent supporting the approval of staking rewards. It seems increasingly likely that it is a question of when, not if, staking will be incorporated.